IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. ——

78-463

CHESTNUTT MANAGEMENT CORPORATION,

Petitioner,

v.

ELEANOR C. MILLER,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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CHESTNUTT MANAGEMENT CORPORATION* (a Connecticut Corporation) seeks a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Second Circuit entered April 3, 1978.

Opinions Below

The judgment is not reported (A19).** The statement by Judge Timbers rendered from the bench is not

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* Petitioner, its parent Chestnutt Corporation and George A. Chestnutt, Jr., its president, are generally called "Chestnutt" herein.

** "A——" refers to appendix hereto. "——a" refers to appendix below.

reported and is printed A23. The panel affirmed the judgment on a jury verdict rendered in one hour and ten minutes following a three day trial upon which judgment was entered October 21, 1975 awarding Respondent Eleanor Miller*** exactly $53,000 against investment adviser Chestnutt. Senior Judge Murphy had denied motions to dismiss at the end of plaintiff's case and the entire case and refused defendants' charges (printed A8 hereto). His charge is printed A11. On September 20, 1977 Judge Murphy denied Chestnutt's Motion for Judgment Notwithstanding the Verdict, or alternatively, for new trial.

Jurisdiction

This Court's jurisdiction is invoked pursuant to 28 U.S.C. §1254 (1). The entry of the Court of Appeals judgment was April 3, 1978, and a timely Petition for Rehearing with Suggestion for Rehearing En Banc was denied June 22, 1978.

Questions Presented

1. Whether financial writing published to the world is free speech, or whether the First Amendment permits money damage under a criminal statute*

—Where, the only attempt to allege or prove the "circumstances constituting fraud . . . with particularity" required by Rule 9(b), F.R. Civ. Pr., consisted of:

a. the 17th Edition of a 20-year old book, filed annually with the SEC,

*** Her husband Dudley acted for her throughout and they are generally called "Miller" herein.

* Investment Advisers Act of 1940, Sec. 217; 15 U.S.C. 80b-17.

b. a magazine article by an independent third party in a professional journal,

c. about 75 weekly, two-page opinion letters by Chestnutt accompanied by four pages of unchallenged facts filed weekly with the SEC,

d. a "D minus" grade conferred by *Forbes Magazine* upon a different investment advisory client of Chestnutt,

with all of which views and opinions an "expert" stockbroker formerly employed by *Forbes Magazine*, over objection, disagreed;

—and—

—Where, there was neither allegation nor proof of misstatement or omission of any historical fact, either material or immaterial;

—and—

—Where, no security or transaction was alleged, or even identified, to involve fraud under federal or state law;

—and—

the gravamen of the complaint was failure to order "short sales" by Miller's independent third party broker contrary to Chestnutt's published views that stock prices were more likely to advance than decline, which advances occurred promptly after Miller ordered an account liquidated.

Necessarily embraced in the foregoing is the denial of Fifth Amendment due process for vagueness (*Winters* v. *New York*, 333 U.S. 507 (1948) and *First National Bank, etc.* v. *Bellotti*, —— U.S. —— (1978)) and the substitution of presumption for proof and causation (*Tot* v. *United States*, 319 U.S. 463 (1943) and *Thompson* v. *Louisville*, 362 U.S. 199 (1960)).

2. May a private right of action for damages be implied under the Investment Advisers Act of 1940,* under which statute (and Regulations) this is believed to be the first final* judgment awarding damages.

Constitutional and Statutory Provisions Involved

This case invokes freedom of speech and press under the First Amendment and the Due Process Clause under the Fifth Amendment to the Constitution of the United States. Also involved are Sections 206, 214 and 217 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6, 14 and 17) and Reg. §275.206(4)-1 thereunder, printed in the Appendix (A26-30).

Statement of the Case

Introduction

This case indicted a book published in 1952 (17th Ed., copyright 1969 with factual tabulations through 1968, in evidence to the jury in 1975 as Ex. 5) and punished the author. Not only its quarter-century old cartoons, but also a ten-column copyrighted magazine article written in *Medical Economics* (Ex. 4) by its Senior Editor, constituted federal securities "fraud", as did some 75 weekly letters of opinion published worldwide (Ex. 3).

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* Justices Stewart and Powell would have granted certiorari on the pleadings in *Fleschner* v. *Abrahamson* (No. 77-1279, *cert. den.* May 15, 1978). For the reasons stated in that petition, and by Judge Gurfein dissenting therein below (568 F.2d at 879), and by Judge Hill, dissenting in *Wilson* v. *First Houston Inv. Corp.*, 5 Cir. 1978, 566 F.2d 1235, 1243 (*pet.* pending, *First Houston Investment Corp.* v. *Wilson* (No. 77-1717)) the petition herein should be granted.

This unconstitutional consequence was upon the causal *nexus* that *Forbes Magazine* opined a "D minus" grade to a different Chestnutt advisory client American Investors Fund, Inc. which in a couple of decades of operations has appreciated in value about 3½ times the Dow-Jones Industrial average, or plus 339% vs. plus 101%.

The courts below drummed published financial opinion out of the First Amendment mansion in the following manner.

Petitioner Chestnutt believed and wrote that the savage stock market *débacle* in spring 1970 was overdone, and he published weekly—worldwide—the word "bullish" * and his opinion that prices were more likely to advance than decline. Respondent Miller saw a headline in Paris, ordered an account maintained with a third party broker (Spencer Trask & Co.) liquidated, and sued for federal statutory and Connecticut fraud for Chestnutt's failure to order "short sales" in Miller's account.

No historical fact published by Chestnutt was challenged. There was no claim of omission of any historical fact or failure to keep Miller currently and exactly informed of the account. No security or transaction was alleged or even identified as involving "fraud", federal or state.

Miller's counsel summed up to the jury as to Chestnutt's opinion:

> "The only information that he had as to the *future* of the market is right here in Exhibit 3. The only *prognostications* made that were available to Mr. Miller were right here. . ." (456a, emphasis added).

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* The decisions below permit a jury to make criminal and subject to incalculable liability the television picture of a "Thundering Herd" and the statement "Merrill Lynch is Bullish on America". See *Winters* v. *New York*, 333 U.S. 507 (1948).

Over no less than nine objections (22a, 23a, 27a, 38a, 39a, 50a, 51a, 52a, 54a-56a), one Quick,* who became a stock broker after the events complained of, opined the market trend was "bearish" for the five months from November 26, 1969 through April 1970. (188a-198a).

The judge, among other things, compelled the jury on the basis of expert testimony to find an orthodox dogma of financial opinion as to future stock prices, charging:

> ". . . a Wall Street broker who has by reason of education and experience become expert in his profession or trade or business may be permitted to state his opinion as to a matter in which he is versed and which is material to the case. He also may state the reasons for his opinion.
>
> You *should* consider the opinion of the two[*] experts that we had. You can reject the expert's opinion entirely if you conclude that the reasons given in support of the opinion are unsound." (A15, Emphasis added).

Shortly after Miller's panic liquidation, stock prices moved sharply higher, reaching all time highs by January 1973.

A six-person jury after a three day trial and in an hour and ten minutes on Friday afternoon awarded exactly $53,000. Judge Timbers dictated affirmance from the bench (A23).

The 65-paragraph complaint (denied generally) alleges weekly publication of "Stock Market Survey" Reports and management of American Investors Fund, Inc. (¶2). (7a, ff.)

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* Employed by *Forbes Magazine* in 1969 and 1970.

* The judge apparently treated George Chestnutt, who has never been affiliated with a broker or dealer, as the second "expert".

¶28 alleged:

> "28. On various and divers occasions from February 16, 1969 to April 24, 1970, defendants, or one of them, made to plaintiff *through their various publications* several statements which were false and misleading about the *state of the securities market in the United States* and which, on information and belief, were known to defendants to be false and misleading, or, in the alternative, should have been known to defendants to be false and misleading." (Emphasis added).

The virtues of "short sales" were extolled in ¶'s 8, 50(d), 63, and ¶64 reads:

> "64. Market conditions, on many occasions during the period February 16, 1969, to April 24, 1970 *dictated the employment of the 'short sale'*. Defendants, recklessly and with apparent disregard for the financial interests of plaintiff, failed to 'sell short' for plaintiff's account." (Emphasis added).

The four purported causes of action went to the jury as a claim under Section 206 of the Investment Advisers Act and a claim for Connecticut common law fraud.

Further Statement and Chronology

About 1952 George A. Chestnutt, Jr. published:

"Stock Market Analysis
Facts and Principals"

which (as well as subsequent editions) was filed with the Securities and Exchange Commission, its 17th Edition, called the "Redbook" in the record, copyright 1969 by Chestnutt Corporation, is Ex. 5 (577a, ff.).

Philip Harsham, Senior Editor, *Medical Economics*, wrote a ten-column article entitled "Profiting from Stock Market Psychology" in that professional magazine (copyright 1968 by Medical Economics, Inc., a subsidiary of Chapman-Reinhold, Inc., Oradell, N.J.) relating to Chestnutt, a copy of which went to the jury as Exhibit 4. It is A1-7 hereto, photographs excluded. Mr. Harsham's first sentence reads:

> "Wall Streeters call George A. Chestnutt, Jr. a maverick, and they may be right."

Mr. Harsham reported Chestnutt as saying (A2):

> "That's because the majority let their emotions dictate their investment moves." "It's the worst thing they can do", says Chestnutt, "the stock market will do whatever it has to do to prove the majority wrong."

The "Redbook" has outlined Chestnutt's selection of objective data, and includes for 23 years through 1968 the actual percentage market performance (plus *and* minus) of 63 industry groups compared to the percentage plus *or* minus of the 800 stock geometric average originated by Chestnutt in 1947* and the Dow Jones averages.

The "Redbook" under 24 headings outlined Chestnutt's philosophy on the basis of which each week since 1951 he has written, signed and published throughout the world a two page opinion letter on the stock market with 4 pages of statistics. Weekly issues (March 1969-April 1970, with certain gaps) went to the jury as Exhibit 3 (465a-570a).

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* This original undistorted percentage concept, applied initially in 1947 to 400 stocks was increased successively to 1,000 stocks by 1970. The concept has been emulated by the "Value Line Geometric Average" now widely reported in various publications.

Like the "Redbook", each weekly publication of "American Investors Service" has been filed with the Securities and Exchange Commission, as have two decades of registration statements including the prospectuses of American Investors Fund, Inc. describing Chestnutt's analytical methods and each showing ten years investment results.

In May 1968 Dudley E. Miller,* unannounced and unsolicited dropped into Chestnutt's office in Greenwich because a fellow oilman abroad, Mr. Squires, had suggested it. (316a).

At the time of trial Miller for 3½ years had been Eastern Hemisphere Vice President and General Counsel for Occidental Petroleum.

Chestnutt's officer Murray showed him the record, as Miller admitted, of *all* managed accounts over a period of "several years" which Miller further admitted " . . . varied from account to account, but certainly for 2 to 3 years at a minimum". (330a). Miller was given a copy of the "Redbook" (Exhibit 5) which he described as "very complete and expresses a lot of the feelings I have in the stock market". (277a).

Nine months later, and after receiving in the mail a copy of Harsham's ten column article in *Medical Economics*

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* He acted for his wife, Plaintiff-Respondent throughout. The Millers live in London. He began his career as staff counsel in New York for U.S. Life for 3 years doing international, tax, corporate, labor and insurance law; went with ARAMCO in New York, then to Holland and then to Arabia doing general practice and contract problems. From 1963 to 1969 he was general counsel for another consortium, Oasis Oil Company, in Libya. After a period with "Oxy-Libya" and having an additional office in Paris, Mr. Miller had for 3½ years before trial been Occidental Petroleum's Eastern Hemisphere Vice-President and General Counsel in London (257a-266a). Mrs. Miller, formerly a nurse, had done post graduate work at Johns Hopkins University in neurosurgery (101a).

(Exhibit 4) and after conferring with the fellow oilman abroad, in February 1969 Miller engaged Chestnutt to place, buy and sell orders with her long-standing broker, Spencer Trask & Company, for which Chestnutt received a quarterly fee of $325.00, plus one quarter of 1%, which amounted to $653.26 on the initial portfolio value of $131,305.62 as of February 28, 1969. (680a).

Miller received physically in Tripoli a confirmation slip within 5 to 8 days for every portfolio transaction, as well as monthly reports showing exact portfolio and cash positions. (281a-282a, 321a). He also received each week within 5 to 8 days Chestnutt's current opinion and the factual information upon which the opinion was based in the six page publication American Investor's Service. (Exhibit 3)*.

The account prospered for a few months. The one-page engagement of Chestnutt could be terminated at will (Exhibit 1, 463a) and was accompanied by a one page limited power of attorney furnished to her broker Spencer Trask

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* Each published letter (filed with the Securities and Exchange Commission) included:

1. The *actual* closing prices of 800 stocks.
2. The *actual* Dow Jones average and weekly change, plus charts of other averages.
3. The *actual* American Investors 800 stock geometric average and weekly change.
4. The ranking of each of such 800 stocks in accordance with their "relative" market strength, ranking from 0 to 99.
5. The ranking of 65 industry groups, and the individual ranking of the 800 stocks within its group.
6. The number of the 65 groups which had advanced in fact and the number of groups which had declined in fact.
7. A proprietary "Trend Oscillograph" showing plus or minus in figures where the market as a whole appeared to be trending in the Adviser's opinion.
8. A narrative opinion letter expressing the Adviser's interpretation of what the "market trend evidence" appeared to be.

& Company authorizing only acceptance of buy and sell orders. (Exhibit 2, 464a)*.

The Jury Was Required To Try Written and Published Opinion.

Miller's counsel closing to the jury (427a, ff.) itemized his bill of attainder separately against the 20-year old Redbook (Ex. 5), the weekly opinion letter (Ex. 3) and the *Medical Economics* article (Ex. 4), described as a "testimonial", and the "D minus" rating by *Forbes Magazine* of American Investors Fund, Inc., a different client. The Judge's charge (A11) lumped them together.

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* Chestnutt never had control or possession of assets. Chestnutt has no affiliation or interest in brokerage or underwriting and has always squarely conformed to the high standards set for investment advisers in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), that there be no conflicting activity to impair investment judgment, stating at 190:

> ". . . not engaged in any activity such as security selling or *brokerage*, which might directly or indirectly bias an investment judgment . . .". (Emphasis added)

And the Court stated earlier

> "The report stressed that affiliates by investment advisers with investment bankers, or corporations might be 'an impediment to a disinterested, objective, or critical attitude toward an investment by clients . . .'" (at 187-188),

and further:

> "The report incorporated the Code of Ethics and Standards of Practice of one of the leading investment counsel associations, which contained the following canon:
>
> "[An investment adviser] should continuously occupy an impartial and disinterested position, as free as humanly possible from the *subtle* influence of prejudice, *conscious or unconscious;* he should scrupulously avoid any affiliation, or any act, which subjects his position to challenge in this respect." (at 188, emphasis the Court's)

Not a single security transaction was identified by either as claimed to be fraudulent. Not a single existing fact was challenged.

(A) As to the Redbook

Mentioned repeatedly, a few quotations suffice:

> "Look at the red book or what I have been calling the red book. I want you to look first, if you will, at all the graphs, all the charts. There are a lot of them, 2, 3, 4, 5, they go on, 6, then you go in the back and count a lot more." (430a)
>
> "Mr. Miller testified exactly to the contrary, that he was never told of a limitation of this book. You've got some cartoons in here too. Page 24, a poor fellow is on the train going the wrong way and wants to get off. Page 14, I have another cartoon, somebody at the betting window down at Yonkers or someplace like that. (431a)

• • •

"I'm going to go with them." and he was particularly impressed by this technique, tactic, sometimes it's called of selling short. He is a believer in the short sale and he made an inquiry about the short sale. (432a)

"• • • The book talks about the value of the short sale." (432a)

"There's also another statement in here that's pretty interesting and Mr. Chestnutt, I believe, testified to it. Page 7, it says 'This geometric average was designed to satisfy the need for a scientifically accurate index of average general market performance.' He said and he testified that it is a scientifically accurate tool. If you find it is not a scientifically accurate tool, I think you would find too that that was a violation of the Securities Law." (433a)

(B) As to Senior Editor's Harsham's 10-column article published in *Medical Economics*:

> "Mr. Miller in May went to see Chestnutt. A while later, he was mailed this document, Profiting From Stock Market Psychology. We claim that this document is a testimonial, a testimonial to the ability of Mr. George Chestnutt, the boss, as Mr. Lee characterized him today, the boss of Chestnutt Management and Chestnutt Corporation. And we maintain that this is a violation of a Federal Securities Law." (430a)

(C) As to the "D minus" rating by *Forbes Magazine* of American Investors Fund, Inc.:

> "The organization that he invested with had a D or D minus rating from Forbes." (438a)
>
> • • •
>
> "This, on top of the D rating in the market. . ." (439a)

(D) As to the Weekly Stock Market Survey (Ex. 3):

There was no challenge to any fact in four pages, or claim that Chestnutt did not act in accordance with his opinion expressed in two pages.

> "The monthly brokerage statements . . . was just a history for a period of 30 or 31 days, whatever. The only information that he had as to the *future* of the market is right here in Exhibit 3. The only *prognostications* made that were available to Mr. Miller were right here . . ." (456a) (Emphasis added)
>
> ". . . this thing they call the Stock Market Survey, I think is perhaps the most important." (434a)
>
> "Now, the Stock Market Survey used this word 'bullish' as I read to you before. Was the American securities market in the period February 1969 to April of 1970 bullish?

Remember Mr. Quick's example about the tide. Mr. Quick testified that in his opinion it was bullish. He testified that it was bullish up to about November 26, 1969, and thereafter, through the period in question and indeed through most of May, the market was bearish. The tide was going out. In no week during that period did he testify the tide was coming in." (435a)

The trial judge rejected the crucial portions of Chestnutt's proposed charge (A8). He made the charge printed A11, permitting the jury to treat a magazine article as a "testimonial" in violation of the Act, a book as criminal, and an *opinion* as to the *future* as a material fact, imposing absolute liability. He charged:

"It is not necessary to prove that the maker of the statement had a guilty intent. It is sufficient if the statement was made without reasonable grounds or made recklessly.

If you find that the statements that were made if, in fact, they were made, were statements of opinions relative to the conditions of the securities market, it doesn't make any difference because if the opinion was given by a professional person whose services had been engaged, the opinion was false because of a lack of due care and a defendant would be liable." (A13-14)

Throughout the 1975 trial, a half-year before *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), "advertising" and "testimonial" under Reg. 275.206(4)-1 were utterly confused with the statutory words "device, scheme or artifice to defraud a client" (§206(1)) and the statutory words "fraudulent, deceptive or manipulative" (§206(4). As applied, the Regulation not merely exceeded the legislative grant, but violated free speech and was vague contrary to due process.

Reasons for Granting the Writ

I

Left standing, the decisions below permit jailing a financial writer for a 20 year old book.*

Left standing, the decisions below would endanger an author selling his book, unless accompanied by the "D minus" grade of a hostile reviewer.

Left standing, the case creates absolute liability—not only for writing—but even for being *written about* (Ex. 4, A1-7). While the first sentence of the ten-column magazine article by the Senior Editor of *Medical Economics* does indeed refer to Chestnutt as a "maverick", this "animal metaphor" even when added to "bullish" and "bearish" does not resemble a "pig in the parlor". *FCC* v. *Pacifica Foundation,* —— U.S. ——, 98 S.Ct. 3026, 3041, 3049 (1978). Moreover, one should add, neither the Redbook in its many editions (Ex. 5) nor the weekly opinion letter (Ex. 3), both filed through the years with the SEC, has over the decades occasioned "any of the available sanctions [the SEC] has been granted by Congress". *id.,* 98 S.Ct. at 3030.

As a consenting adult and California and New York international lawyer, Miller spent May 1968 through February 1969 reading the Redbook (Ex. 5) and the magazine

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* Our fatuous hope when privileged to be of counsel a quarter-century ago in *Joseph Burnstyn, Inc.* v. *Wilson,* 343 U.S. 495 (1952)—the year Chestnutt first published his Redbook—was that the unparalleled concurring opinion of Mr. Justice Frankfurter had forever banished silliness, as well as terror and punitive damage, where some regulation may be permissible.

article (Ex. 4), all the while a bull-market raged ever higher. During this nine-month gestation, had he been besieged with sound trucks blaring their contents, all Justices would have agreed that the contents could not be censored, or punished. *Kovacs* v. *Cooper,* 336 U.S. 77 (1948).

While Chestnutt is a writer and publisher and not a national bank, it must be recognized, *First National Bank, etc.* v. *Bellotti,* 46 L.W. 4317, 4378, Note 31:

> "... The First Amendment rejects the 'highly paternalistic' approach of statutes like §8 which restrict what the people may hear. *Virginia State Bd. of Pharmacy* v. *Virginia Citizen Consumers Council, Inc.,* 425 U.S., at 770; see *Linmark Associates, Inc.* v. *Township of Willingboro,* 431 U.S., at 97; *Whitney* v. *California,* 274 U.S. 357, 377 (1927) (Brandeis, J., concurring); *Abrams* v. *United States,* 250 U.S. 616, 630 (1919) (Holmes, J., dissenting)."

The *Bellotti* case completes the interweaving of public policy free speech and commercial free speech, irrespective of the speaker.

But the decisions below go far beyond the evil perceived in *New York Times, Inc.* v. *Sullivan,* 376 U.S. 254 (1964), and deprive Chestnutt even of the defense of truth of every fact stated. The decisions below impose absolute and punitive liability for opinion.

The decisions below would hang actuaries for epidemics and drown messengers in wells. They exclude financial writing from free speech.

II

We plagiarize and adopt the reasons set forth in the petition in *Fleschner* v. *Abrahamson* (No. 77-1279, *cert. den.* May 15, 1978) which two Justices would have granted, referred to *supra,* p. 4.

We add that everything decided and said in *Blue Chip Stamps* v. *Manor Drug Store, Inc.,* 423 U.S. 884 (1975) applies even more to alleged fraudulent failure to "sell short".

We mention again that *Hochfelder, supra,* was decided after the trial judge made his charge.

For convenience we reprint in the margin notes 7 and 8 (page 8) from the *Fleschner* petition.*

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* "[7] *Lewis* v. *Transamerica Corp.,* No. 75-1285 (9th Cir., docketed 1975) (argued May 12, 1977).

[8] The district courts have divided on the issue: *Sullivan* v. *Chase Investment Services of Boston,* 434 F.Supp. 171 (N.D. Cal. 1977) cause of action implied after dismissal of 10b-5 claim); *Angelakis* v. *Churchill Management Corp.,* [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,285 (N.D. Cal. 1975) (cause of action implied); *Lewis* v. *Transamerica Corp.,* No. C 73-2180 (N.D.Cal. 1974) ("no Federal jurisdiction" and no right of action; oral decision by District Court, *see* transcript of argument held Sept. 27, 1974 at 10), *appeal argued,* No. 75-1285 (9th Cir., May 12, 1977); *Bolger* v. *Laventhol, Krekstein, Horwath & Horwath,* 381 F.Supp. 260 (S.D. N.Y. 1974) (cause of action implied); *Greenspan* v. *del Toro,* [1975- 1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,488 (S.D.Fla.) (noright of action), *appeal dismissed for want of prosecution,* No. 74-2943 (5th Cir. 1974); *Gammage* v. *Roberts, Scott & Co.,* [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,760 (S.D.Cal. 1974) (no right of action)."

CONCLUSION

For the foregoing reasons, and those incorporated herein, a writ of certiorari should issue to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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APPENDIX

Exhibit 4

Profiting from Stock Market Psychology

By Philip Harsham
Senior editor, Medical Economics

(Photos Omitted)

Wall Streeters call George A. Chestnutt Jr. a maverick, and they may be right. But no single label could do justice to the 53-year-old mutual fund proprietor and money manager. Actually, Chestnutt is a dedicated technical stock analyst who believes that an understanding of the market's technical aspects can benefit any investor. He's convinced he has hit upon a stock analysis system that, properly interpreted, can lead almost surely to extraordinary profits. And *he* may be right.

When Chestnutt came out of Montana in 1946, at any rate, he had only $5,000. Now, some 21 years later, he runs a $225,000,000 mutual fund (American Investors Fund) and heads an investment counseling service whose 250 or so clients must have a minimum of $100,000 each. He also publishes a weekly advisory report (American Investors Service) for which investors "who want to kill their own snakes," as he puts it, pay $240 a year.

"You might say that I'm employed full time," he quipped with a deceptively timid grin, as he ushered me into his blue-paneled Greenwich, Conn., office. Aware that Chestnutt's methods had served him and his mutual fund well, I had come calling primarily to see if some of those methods might be put to practical use by doctor-investors. My conclusion: Some of them can be—and profitably.

"We operate on the basis of technical market analysis, yes," Chestnutt says. "But technical information has to

be interpreted in the light of investor psychology. Anybody can keep charts. I'm more a stock market psychoanalyst."

Behind Chestnutt's probings of the market's psyche is the theory that the best source of information for an investor is the action of the market itself. "I usually couldn't care less what a company does," he says. "What I want to know is how its stock has been performing; that's the best clue to how it's likely to perform in the future."

What about such fundamentals as a company's earnings, profit margin, debt position, and growth rate? "All those things are reflected in the market action of the stock," Chestnutt says. Besides, studies he's made over the years indicate that economic factors have only a 15 percent correlation with stock market averages. So he concludes that the market's action is rooted only 15 percent in economics and 85 per cent in psychology. Chestnutt concedes that he and his staff do correlate their technical information with current economic factors. But, he says, "You have to recognize above all that stock prices move up or down because real live people are bidding them up or down." An astute technical analyst can determine by watching the charted trends of prices and trading volume the points at which those people are most likely to be selling or buying.

That's because the majority let their emotions dictate their investment moves. "It's the worst thing they can do," says Chestnutt. "The stock market will do whatever it has to do to prove the majority wrong." Meanwhile, the investor, who lets himself be guided only by accurate technical analysis, totally unencumbered by emotions, can wait for the opportunity to pick up bargains. "All he has to do is hold out his basket," as Chestnutt puts it, "and catch the falling shares."

Can the average doctor-investor play that game? Chestnutt thinks so, "if he's willing to take the time to study

charts and relate them to invester emotions." But even if he can't play it, he can benefit by learning how the professionals play it. The fundamentals behind the psychology of the market are these: At any given time, some investors may have gains in a stock and some may have losses. Those with gains want to safeguard them, and, if possible, build them higher. The motives of those with losses are a bit more complex. Some will opt to cut their losses short by selling out early when the stock's price begins to slide; some will sell the moment a minor rally returns the stock's price to the level they paid; and some will hold on doggedly, awaiting a turnaround. "Everybody has his own flash point," explains Chestnutt. The better acquainted an investor is with the stages at which those flash points might occur, the more profitable his buy and sell decisions will be.

Take a stock like du Pont, as an example. A couple of years ago, it was selling at around 260. It was a "happy-people" stock, to use Chestnutt's terminology, because many of its shareholders were long-term investors with immense profits in it. But those who bought in at 260 or so now have little reason to be happy; from that level, du Pont began a decline that eventually exceeded 100 points.

Analysts charting du Pont's decline could see at various points just what shareholders' emotions were prompting them to do. Eventually, the chart pattern indicated that most of those who intended to get out had gotten out. Du Pont stock drifted listlessly between 145 and 155. It seemed to have hit bottom.

Was that the time to buy? Those who thought so found themselves with gains of 20 to 30 points within very few months. The stock rose for technical reasons even while the company reported disappointing earnings.

Even those stocks in a strong uptrend may rise and fall from time to time. In the Chestnutt lexicon, those price

movements are intermediate-term fluctuations within a major trend. So a stock may be hitting intermediate-term bottoms and tops while the long-term bottom or top is nowhere in sight. The trick, then, is to buy on the intermediate-term bottom, stay with the stock until it approaches its intermediate-term top, then sell before it heads for another intermediate-term low. If the long-term price trend is up, Chestnutt observes, the chances are always good that the next intermediate-term low will be a bit higher than the previous low and that the next intermediate-term high will be a bit higher than the previous high. But regardless of long-term trends, the investor who waits for the dips to occur to do his buying stands to boost his profits.

That Chestnutt approach to buying low and selling high raises some questions: How do you know that the stock isn't going lower—much lower—than the point you've chosen as the intermediate-term bottom? Or how do you know that it isn't going to soar right on through the point that you've determined as the probable intermediate-term top? How do you, in fact, know that you have a stock that's going to do anything at all?

George Chestnutt's answer is, "You have your charts. You figure it out!" It should be noted that Chestnutt has the mathematical mind of an engineer, which indeed he was until his stock market values began taking more time than his job with a Montana utility company. He reads stock market charts as easily as others read the printed word—maybe because he started charting stocks at the age of 13.

A key factor in Chestnutt's method of analysis is the trend of upside and downside volume—the number of shares traded at prices higher than the previous day's prices and the number traded at lower prices. Those

trends, whether applying to the market as a whole or to individual stocks, give a good indication of how bullish or bearish the investing public is at any given time.

It's market "psychoanalysis" of this type that Chestnutt believes an individual investor could be doing for himself. "Everything he needs to work with is published daily in The Wall Street Journal and other newspapers," he says. In these days of computerization, the job is made easier. Most brokers can give you total upside and downside volume of stocks listed on the New York Stock Exchange simply by pressing buttons on their market monitors.

Here's how Chestnutt explains the principle of volume analysis to subscribers to his weekly advisory service:

"If you had unlimited capital, you could test the market for any stock by alternately throwing in large buying and selling orders. Suppose you wanted to test the market for U.S. Steel; that is, determine which was heavier, supply or demand. Suppose steel is selling at 40, and the market is quiet.

"You start giving your broker buy orders until you have forced the price up to 41. At that point, you stop to note that it took 15,000 shares to put the price up a point. During that time, other people bought 10,000 shares so that the total volume in U.S. Steel was 25,000 shares.

"You wait a while because you've created a little excitement by your buying, which is the sort of thing that attracts the attention of others to the stock. Let's suppose that U.S. Steel falls back and stabilizes at 40½. You might conclude that your buying 15,000 shares had caused a ½-point increase in the price.

"Now, you make another test by giving your broker sell orders until you have forced the price down one full point to 39½. Again you stop and note that it took only 10,000

shares to put the price down a point. During that time other people sold 5,000 shares so that the total volume to drive U.S. Steel down a point from 40½ to 39½ was only 15,000 shares, against 25,000 to put it up from 40 to 41. Again you sit back and watch it, and you observe that the price has now apparently stabilized at 39⅝. What conclusion could you draw?"

The conclusion would be obvious, says Chestnutt: The stock is more likely to go down than up. The reasoning goes like this: More shares were required to drive the price up than were needed to drive it down. You and others are left with an excess of 10,000 shares while the net price has dropped ⅜ point. So supply apparently exceeds demand by 10,000 shares, and the stock is weak.

Fortunately, you don't need to test the market with unlimited capital. "Actual buyers and sellers are doing it for you every day," says Chestnutt. The daily volume figures indicate where majority investment sentiment lies. By recording daily price changes and volume figures over a period of time, it's possible to judge whether a trend is likely to change in the near future.

Volume analysis is just one of the important elements in Chestnutt's sophisticated analytical method—which, he hastens to point out, is certainly not infallible. "But we've run up a pretty good batting average with it," he says. He can point to published figures for American Investors Fund that show gains in per-share net asset value averaging 19 per cent a year since the fund was started. And he can point to a number of managed individual portfolios that show gains of better than 30 per cent a year. "Of course, we can buy on margin or sell short for our managed accounts," he explains.

Those tactics are forbidden to mutual funds; and, as far as Chestnutt is concerned, they should be forbidden to a busy doctor—or any other investor—who can't devote very nearly full time to the market. "If you're going to play the speculator's game," he says, "you should have professional help. Get an investment counselor if your account is large enough to make his fees worthwhile. And if it isn't that large you'd be wise not to play that game at all."

As a man who manages millions for others, Chestnutt has some thoughts on how those who use investment counselors can do so to best advantage. "I prefer to be given full discretion," he says. "I might make a wrong move for an account. But, obviously, I'm not going to make a move that I think will be wrong—the better my clients' accounts look, the better I look. Still, some clients prefer to tie your hands." Some specify that no margin trades or short sales will be made for their accounts. Some rule out purchases of liquor or tobacco company stocks. "That's all right with me," Chestnutt says, "so long as they recognize that imposing such restrictions on me might cut down their gains. Most investors do. But, you know," he grins, hooking his thumbs Western-style under his belt, "some people complain even if they're hanged with a new rope."

Petitioner's Proposed Charges

"1. There is no basis for liability on the ground that plaintiff's account was worth less at the time it was sold out on orders of the plaintiff's husband than it was earlier.

"2. You are not to consider whether defendants did a good job, or not so good, or a poor job.

"3. You are to remove from your minds all questions except whether defendants acted fraudulently or deceitfully.

"4. To find for the plaintiff you must consider whether defendants set out, on purpose, to mislead plaintiff. You cannot consider whether defendants are as good, or better, or worse in their skill in investments than you might be, or someone else might be.

"You may believe that defendants are more optimistic and have greater confidence in their abilities than you have, or is warranted by the facts, but that is not ground for finding any liability.

"5. To find any liability you must be convinced by a preponderance of clear and convincing evidence that the defendants made false representations of a material fact.

"By false, you must understand something untrue, and that the defendants knew it was untrue when it was made.

"In addition you must find this falsity related to something material, which means important, and this was what led or induced and caused the plaintiff to enter into the advisory agreement.

"What type of statement, true or false, would lead this plaintiff whose husband acted for her, to make the agreement? You must understand that the husband acted for his wife throughout, and his knowledge and experience

and skill must be considered as to what would lead him to act.

"Since, when the agreement was made, the account was to be managed in the future, in order to find for the plaintiff, you must find that when the agreement was made, defendants did not intend to carry it out—that is, the management of the account—according to their best ability.

"7. Thus far, to decide in favor of plaintiff you will have had to consider, and on the basis of the preponderance of clear and convincing evidence, decided that defendants deliberately and on purpose; first, hid something from the plaintiff or told an untruth about something important or material, and second, that plaintiff and her lawyer-husband who had the experience of the world which is in the record was fooled by it, and relied upon it.

"In short, to reach this point in your deliberations, you must have decided after being persuaded on the basis of clear and convincing evidence that:

(a) defendants concealed or misrepresented the true facts, and did not intend to do as well as they could with plaintiff's account and lied when they undertook to manage the account, and also that

(b) Mr. Miller, the plaintiff's husband and agent—as a lawyer and executive of many years experience with international oil companies—relied on the misrepresentation and was in fact fooled or misled by the false statement or statements.

"8. These are preliminary steps up to this point.

"You recall that it is undisputed that stock prices in general went down from the time the management account was opened.

Petitioner's Proposed Charges

"You will also remember that plaintiff's husband by cable ordered the stocks sold.

"You must take these undisputed facts into account.

"Since these facts did occur, namely, falling stock prices and the direct instructions of plaintiff's husband to sell, then, in order for you to find any injury or damage, you must be satisfied that a specific stock in the account on the day the account was ordered to be sold was previously bought in bad faith, without regard to whether plaintiffs thought it was a good purchase for the account.

"Thus, even though you may have decided that the making of the agreement was induced by misleading statements or concealment, to find any liability or injury you must further find that a specific stock or specific stocks held at the time the account was liquidated was bought for some other reason than the best interests of the account.

"As to any stock held in the account at the time plaintiff's husband ordered the account sold out and bought in bad faith by the defendants, you may then fix the measure of damage for each of such stocks at not more than the difference between the purchase price of such stock and the price at which it was sold."

District Judge's Charges

The Court: Ladies and gentlemen, I am sure you will agree that this has been a little bit out of the ordinary garden variety case that juries usually hear. I thought the case was interesting. At least we had a vicarious trip to some exotic lands and a limited view of Wall Street by some experts. And with due respect, I thought Mr. Miller's voice was not unlike the late Sidney Greenstreet's.

But whether a case is interesting or not, I am sure you know that the most important part of the case is the part that you people are going to play in a little while because you are going to decide whether or not the Chestnutt Management Corporation owes any money to Mrs. Miller and, if so, how much. And I suggest to you that you decide those issues according to the oath that you took some weeks ago when you told us through the Clerk that you would well and truly try the issues joined and a true verdict give; and I suggest further that you cannot do it according to your oath if for one minute you let emotions like bias or prejudice or sympathy enter into your thinking or your deliberations. I know that if you do it according to your oath, you will do it the way you resolve an important matter at home or in business, and if you do that, then justice will be done and that is all that anybody asks.

Now, this is a civil lawsuit and in a civil lawsuit the burden is on the plaintiff to prove every essential element of her claim by a preponderance of the evidence. This test, the preponderance of the evidence test applies to plaintiff's first claim under a Federal Statute which I will explain.

The test with regard to her second claim which is based upon fraud is that fraud must be strictly proven and the evidence must be clear, precise and unequivocal.

Now, if the plaintiff fails in the burden that is imposed upon her, then your verdict must be for the defendant. If you find on weighing all the evidence that the scales are even balanced, then your verdict must also be for the defendant because, obviously, the plaintiff has not persuaded you. But if you find on weighing all the evidence that the scales tip ever so slightly in favor of the plaintiff, then, of course, she has persuaded you and she is entitled to your verdict.

Now, the plaintiff, Mrs. Miller, sues two corporations, one called the Chestnutt Management Corporation and the other, Chestnutt Corporation. You are to concern yourself only with the Chestnutt Management Corporation since that is the company with which she made her investment agreement.

Now, Mrs. Miller, as I indicated, has two claims which she advances. Either one or both, if proved, will entitle her to the damages that she has proved.

The first claim is based upon a Federal Statute which is called the Investment Advisers Act of 1940. That law provides in part it is unlawful for any investment adviser by the use of the mails or any means of interstate commerce to employ a device or scheme or artifice directly or indirectly to defraud a client. These words include the publication or circulation of any advertisement which directly or indirectly refers to a testimonial of any kind concerning the investment adviser or concerning any advice analysis or report or other service rendered by the investment adviser.

It is Mrs. Miller's claim that the defendant, Chestnutt Management Corporation did employ such testimonials and also the Company employed graphs and charts and other formulas which implied that these graphs and charts

and formulas could be used to determine what securities to buy or sell and when to buy or sell without disclosing prominently the limitations on such graphs or charts or formulas. If you find that the defendant did these things, you may find that such are in violation of the Investment Advisers Act or if you find that any advertisements or brochures or surveys of the defendant, Chestnutt Management Corporation, which were conveyed by the mails contained any untrue or false statement of a material fact, you may find that this also is a violation of the Act.

All this is so because an investment adviser like the Chestnutt Management Corporation occupies a position of trust and as such is a fiduciary upon whom an affirmative duty of the utmost good faith has been imposed and affirmative objection to employ reasonable care to avoid misleading a client.

Now, the second claim that the plaintiff advances is that the defendant, Chestnutt Management Corporation, made false and misleading statements about the condition of the securities market. In order to prevail on this count, the plaintiff must prove by clear and precise and unequivocal evidence, (1) that there was one or more false representations; (2) that the representation was of an existing fact; (3) that it was fraudulently, recklessly or negligently made; and (4) that the plaintiff relied on it and that she was damaged thereby.

It is not necessary to prove that the maker of the statement had a guilty intent. It is sufficient if the statement was made without reasonable grounds or made recklessly.

If you find that the statements that were made if, in fact, they were made, were statements of opinions relative to the conditions of the securities market, it doesn't make any difference because if the opinion was given by a pro-

fessional person whose services had been engaged, the opinion was false because of a lack of due care and a defendant would be liable.

On the other hand, I must tell you that merely because plaintiff's account was worth less at the time it was sold out on the order of the plaintiff's husband than it was earlier, it is not a basis for liability of the Chestnutt Management Corporation. The question is not whether Chestnutt Management Corporation did a good job or not so good or a poor job. If you find liability, you must be convinced with reference to the alleged statutory violation that is the first claim—you must be convinced with regard to the alleged statutory violation, the first claim, by a fair preponderance of the evidence that the defendant employed a scheme or artifice or device to defraud a client.

With reference to the second claim, namely, that the defendant made false representations of a material fact, that is something untrue, and the defendant knew it was untrue when made and that it was material. On the second claim, fraud, as I said, must be proved by clear and convincing evidence and precise.

Remember too that the defendant corporation is not an insurer of plaintiff's account. It is an investment adviser only.

Now, one of the issues in the case which is in every case and that is the question of credibility. In short, who is telling the truth? No one that I know of has come up with a slide rule or a caliper to tell us how to measure it, but everybody agrees that you do it by applying your own God-given common sense and your experience at home and in business. Did the witness have any reason for lying or did he or she have a motive? Was he or she candid and honest? Was he or she interested in the results of the trial?

And was his or her recollection as good as he or she said it was? You determine all of these things based upon your experience at home and in business and, of course, if you find that a person testified falsely to a material fact, you are at liberty to disregard that testimony or you can accept what you believe and disregard what you do not believe or you can, if you wish, disregard that witness' entire testimony.

Now, the question of the credibility of witnesses, of course, is solely within your province. And the rules of evidence do not ordinarily permit a witness to express his opinion. An expert witness, however, is an exception to this rule. A witness such as a doctor or an engineer or a Wall Street broker who has by reason of education and experience become expert in his profession or trade or business may be permitted to state his opinion as to a matter in which he is versed and which is material to the case. He also may state the reasons for his opinion.

You should consider the opinion of the two experts that we had. You can reject the expert's opinion entirely if you conclude that the reasons given in support of the opinion are unsound. And, of course, if you find as I said with regard to another witness, any other witness, that the witness testified falsely to a material fact, you are at liberty to disregard his testimony completely or accept so much as you believe.

Now, if you are persuaded that the plaintiff has sustained her burden of proof on either claim or on both claims by the standards of proof that I have explained, then you approach the question of damages. Damages are a sum of money that will fairly and justly compensate the plaintiff for the loss she has actually incurred.

The mere fact that I have explained what damages are does not mean that I believe that she is entitled to damages. If she has not persuaded you, she is no more entitled to the Chestnutt Management's money than she would be to your money or mine. However, if she has proved that she is entitled to the damages, she is entitled to those damages that she has proved.

And now I am sure you know that your verdict in favor of the plaintiff or of the defendant must in either case be unanimous. If you say that you find in favor of the defendant, that is all you need to say. If you tell us that you find in favor of the plaintiff, then you tell us what the amount of money is by way of damages that will fairly and justly compensate her.

I am sure you know that when you retire to the jury room, you will elect one of your own members as a foreman or forelady and he or she will conduct your deliberations and represent you when you return to Court with a verdict.

And I must now talk to the lawyers for a minute or two in your absence. So, please, excuse us.

* * * *

(The following transpired in the courtroom)

The Court: Ladies and gentlemen, I was told that in repeating the burden of proof that is on the plaintiff in connection with the second or the fraud claim, I added a word that I should not have added.

Fraud must be strictly proven and the evidence must be clear, precise and unequivocal. I think I added the word "convincing". So I'm sorry.

You may retire now. Thanks.

(The jury left the courtroom at 2:10 p.m.)

(Court reconvened at 3:20 p.m.)

The Court: Will the foreman identify himself, please?
The Foreman: Roland Nimo.
The Court: Has the jury agreed upon a verdict?
The Foreman: Yes, sir. We have.
The Court: What is the verdict.
The Foreman: We find in favor of the plaintiff.

District Court Denial of Motion n.o.v., etc.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT
Civil Action No. B-477

ELEANOR C. MILLER,

Plaintiff,

vs.

CHESTNUTT MANAGEMENT CORPORATION and
CHESTNUTT CORPORATION,

Defendants.

Defendant Chestnutt Management Corporation's motion for a new trial pursuant to Rule 59(a), Fed. R. Civ. P., and its motion for judgment notwithstanding the verdict pursuant to Rule 50(b), Fed. R. Civ. P., are both denied.

/s/ THOMAS F. MURPHY
Thomas F. Murphy
Senior United States District Judge

Dated: Waterbury, Ct., September 19, 1977.

Court of Appeals Judgment

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
77-7530

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the third day of April one thousand nine hundred and seventy-eight.

Present:

HON. STERRY R. WATERMAN,
HON. WILLIAM H. TIMBERS,
HON. ELLSWORTH A. VAN GRAAFEILAND,
Circuit Judges.

ELEANOR C. MILLER,

Plaintiff-Appellee,

v.

CHESTNUTT MANAGEMENT CORPORATION and
CHESTNUTT CORPORATION,

Defendants,

CHESTNUTT MANAGEMENT CORPORATION,

Defendant-Appellant.

Appeal from the United States District Court for the District of Connecticut.

This cause came on to be heard on the transcript of record from the United States District Court for the District of Connecticut, and was argued by counsel.

Court of Appeals Judgment

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed in accordance with the Court's oral opinion in open court with costs to be taxed against the appellant.

A. DANIEL FUSARO,
Clerk

By /s/ ARTHUR HELLER
Deputy Clerk

Denial of Rehearing

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

DOCKET No. 77-7530

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twenty-second day of June, one thousand nine hundred and seventy-eight.

Present:

HON. STERRY R. WATERMAN,
HON. WILLIAM H. TIMBERS,
HON. ELLSWORTH A. VAN GRAAFEILAND,
Circuit Judges.

ELEANOR C. MILLER,

Plaintiff-Appellee,

—against—

CHESTNUTT MANAGEMENT CORPORATION and CHESTNUTT CORPORATION,

Defendants,

CHESTNUTT MANAGEMENT CORPORATION,

Defendant-Appellant.

Denial of Rehearing

A petition for a rehearing having been filed herein by counsel for the defendant-appellant,

Upon consideration thereof, it is

Ordered that said petition be and hereby is Denied.

/s/ A. Daniel Fusaro
A. Daniel Fusaro
Clerk

Panel Decision Dictated from Bench

[The following statement does not constitute a formal opinion of the Court and is not to be reported. It shall not be cited or otherwise used in unrelated cases.]

UNITED STATES COURT OF APPEALS

For the Second Circuit

Docket No. 77-7530

Eleanor C. Miller,

Plaintiff-Appellee,

v.

Chestnutt Management Corporation and
Chestnutt Corporation,

Defendants,

Chestnutt Management Corporation,

Defendant-Appellant.

Before:

Sterry R. Waterman, William H. Timbers and
Ellsworth A. Van Graafeiland,

Circuit Judges.

New York, April 3, 1978

Statement by the Court at disposition of appeal
in open court.

Judge Timbers:

I assume counsel are aware of the practice in this Court increasingly followed by us to rule from the bench in a

case where we consider it appropriate to do so. We are going to do so here. Our disposition of the case from the bench does not reflect in any way adversely upon arguments or briefs of counsel; on the contrary, just the opposite. Counsel have so aided us in their briefs and oral arguments as to enable us to rule from the bench.

The short of it is, we affirm. Briefly the following are the grounds of our affirmance. In this action, authorized under the law of this Circuit by *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2 Cir. 1977), the case was submitted to the jury on two claims. First, that defendant Chestnutt had violated Section 206 of the Investment Advisers Act of 1940 and Rule 206(4)-1 promulgated thereunder. Secondly, that defendant Chestnutt had committed common law fraud. The jury returned a general verdict in amount of $53,000 in plaintiff's favor on October 3, 1975. Chestnutt moved for judgment n.o.v. or in the alternative for a new trial. The district court denied the motions on September 20, 1977. Chestnutt appeals from the order denying those motions, but not from the judgment itself.

With respect to the claim of insufficiency of the evidence, as indicated or reflected by the statements from the bench during the course of the argument, particularly by my two colleagues, Judge Waterman and Judge Van Graafeiland, we hold that plaintiff presented sufficient evidence from which the jury could have found that Rule 206(4)-1(a)(3) was violated by Chestnutt's representations about its systems of graphs and tables and "Trend Oscillographs", without adequate disclosure of their limitations. Moreover, Chestnutt's intentional failure to disclose its prior performance in bear markets we hold constituted a sufficiently material non-disclosure to support a jury finding of common law fraud.

With respect to the charge—on this aspect of our ruling we assume for present purposes that objections to the charge were properly preserved in the district court—the only matter which we believe merits brief comment is Judge Murphy's use of the word "negligently", in the context of his charge, disjunctively with the words "fraudulently" and "recklessly" as an element of common law fraud. After careful examination of the charge, in the context of the entire record, however, we are satisfied that this does not require reversal, for the reason that, where one makes a negligent representation in violation of a duty of care, scienter, if indeed it is required, is imputed. In support of that we find the following cases to be controlling: *Isen* v. *Calvert Corp.*, 379 F.2d 126, 129-30 (D.C. Cir. 1967), *cert. denied*, 389 U.S. 961 (1968); *Stein* v. *Treger*, 182 F.2d 696, 699 (D.C. Cir. 1950); *Anderson* v. *Tway*, 143 F.2d 95, 99 (6 Cir. 1944); *Shane* v. *Hoffman*, 227 Pa. Super. Ct. 176, 181-82, 324 A.2d 532, 536 (1974).

Those are the reasons briefly stated, among others, upon which we rely in affirming from the bench the judgment of the district court.

Thank you very much.

JUDGE VAN GRAAFEILAND:

I would like to note my reservation to the last portion of the opinion just given; that is the part which equates negligent misrepresentation with scienter. I would prefer to base my affirmance on the appellant's failure to take proper exception to the testimony and to the charge.

JUDGE TIMBERS:

The record will note Judge Van Graafeiland's statement.

Statutory Appendix

TEXT OF STATUTES INVOLVED

Section 206 of the Investment Advisers Act of 1940, 54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6, provides:

PROHIBITED TRANSACTIONS BY REGISTERED INVESTMENT ADVISERS

SEC. 206. It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Section 214 of the Investment Advisers Act of 1940, 54 Stat. 856, 15 U.S.C. § 80b-14, provides:

JURISDICTION OF OFFENSES AND SUITS

SEC. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be as-

sessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

PENALTIES

SEC. 217. Any person who willfully violates any provisions of this title, or any rule, regulation, or order promulgated by the Commission under authority thereof, shall, upon conviction, be fined not more than $10,000, imprisoned for not more than five years, or both.

REG. § 275.206(4)-1. (a) It shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of Section 206(4) of the Act, for any investment adviser, directly or indirectly, to publish, circulate or distribute any advertisement:

(1) which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser; or

(2) which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person; *provided, however,* that this shall not prohibit an advertisement which sets out or offers to furnish a list of all recommendations made by such investment adviser within the immediately preceding period of not less than one year if such advertisement, and such list if it is furnished separately: (A) state the name of each such security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at

that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date, and (B) contain the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body or text thereof: "it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list"; or

(3) which represents, directly or indirectly, that any graph, chart, formula or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula or other device being offered will assist any person in making his own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; or

(4) which contains any statement to the effect that any report, analysis, or other service will be furnished free or without charge, unless such report, analysis or other service actually is or will be furnished entirely free and without any condition or obligation, directly or indirectly; or

(5) which contains any untrue statement of a material fact, or which is otherwise false or misleading.

(b) For the purposes of this rule the term "advertisement" shall include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publica-

tion or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or

(2) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities.

[Adopted in Release No. IA-121, January 1, 1962,
26 F. R. 10549.]